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COMMONWEALTH OF VIRGINIA

STATE CORPORATION COMMISSION

AT RICHMOND, DECEMBER 18, 2001

APPLICATION OF

NORTHERN NECK ELECTRIC COOPERATIVE

CASE NO. PUE010006

For approval of a functional
separation plan

FINAL ORDER

On December 29, 2000, Northern Neck Electric Cooperative ("Northern Neck" or the "Cooperative"), filed an application for State Corporation Commission ("Commission") approval of the Cooperative's plan for functional separation ("Plan") as required by the Virginia Electric Utility Restructuring Act ("the Act"), Chapter 23 of Title 56 of the Code of Virginia (§ 56-576 et seq.) The Act requires that the Commission complete its review of proposed plans of separation by January 1, 2002, and that transition to competition be implemented according to a timeline established by the Commission. Pursuant to an Order issued on March 30, 2001, in Case No. PUE000740, the Commission established January 1, 2004, as the deadline for Northern Neck and other electric cooperatives to provide full retail access for their customers.

The Commission promulgated rules¹ for functional separation as required by the Act. These Rules require the Cooperative to file a Plan that includes a cost of service study separating the Virginia jurisdictional operations into functions: generation, transmission, and distribution, subdivided by class and specifically identifying the costs associated with metering and billing. The Rules also require that the Plan include proposed unbundled rates, tariffs, and terms and conditions for service. Requests for waiver from the required submission of documents under the various sections of the Rules are also permitted.

In its application, the Cooperative stated that it is currently functionally separated. It does not own or control any generation or transmission facilities, nor does it own or control any affiliated entity that owns or controls generation or transmission facilities. Instead, Northern Neck purchases all of its requirements for demand, energy, transmission and ancillary services through contracts with Old Dominion Electric Cooperative and Southeastern Power Administration. As such, Northern Neck stated that it had no plans to divest itself of any generation assets, to create any new functionally separate entity, or to propose to transfer any functions, services, or employees to a functionally separate entity or third party. The

¹ Commission's Regulations Governing the Functional Separation of Incumbent Electric Utilities under the Virginia Electric Utility Restructuring Act ("Rules"), 20 VAC 5-202-10 et seq., adopted in Case No. PUA000029.

Cooperative filed a cost of service study, which included proposed unbundled rates to illustrate the Cooperative's rate unbundling. In its application, the Cooperative requested that the Commission waive the requirement of 20 VAC 5-202-40 B 8 of the Rules to file unbundled tariff rates and terms and conditions of service with the Cooperative's functional separation plan. The Cooperative also requested that the waiver extend until the conclusion of this proceeding so it can finalize and submit such filings in compliance with the final order.

In an Order dated March 2, 2001, in this proceeding, the Commission directed the Cooperative to provide notice to the public and established a procedural schedule for the filing of comments or requests for hearing on Northern Neck's application. In that Order, the Commission directed its Staff to investigate the application and file a Report detailing its findings and recommendations on or before July 9, 2001. The Commission also granted Northern Neck's request for a waiver. However, the Commission required the Cooperative to file tariff terms and conditions of service in time for the Commission to consider them and to require notice to the public, if necessary and appropriate, prior to the Cooperative's implementation of retail choice to its customers.

On June 4, 2001, AES NewEnergy, Inc. ("AES") filed a Notice of Protest and request for hearing in this matter. Specifically, AES requested that a hearing schedule be established to consider issues relating to the allocation of certain costs to the generation and transmission ("G&T") functions, a dual billing option for suppliers, wires charge calculations, and the terms and conditions of service included in any rate tariff or supplier coordination agreement.

On July 9, 2001, Staff filed its Report wherein it recommended that the Commission approve Northern Neck's Plan with the adoption of certain modifications recommended by Staff. Specifically, Staff recommended that the Commission adopt the following: Staff's recommendation to consolidate the Cooperative's G&T functions into one function;² Staff's adjustments to the Cooperative's per books cost of service study; Staff's allocations of expense and rate base to the G&T function; Staff's recommendation that the Commission direct the Cooperative to track the costs associated with G&T operations; and Staff's recommendation that the Commission direct Northern Neck to provide tariff rates and terms and conditions of service in time for full consideration by the Commission.

² Staff noted that the Cooperative does not anticipate providing transmission service to customers who shop for energy.

On July 23, 2001, Northern Neck filed its Response to the Staff Report. In its Response, the Cooperative stated that although it supports Staff's recommendation that the G&T functions be combined, it does not agree with Staff's recommendations pertaining to functional cost assignment. Northern Neck requests that the Commission find that its administrative and general ("A&G") expenses and associated overheads are properly assignable to the distribution function because the rate paid by Northern Neck to Old Dominion Electric Cooperative for power supply and transmission services includes a component for A&G expenses. Northern Neck argued that assigning its A&G and overheads to G&T would, in effect, add a second layer of such costs to the generation component. Further, Northern Neck argued that in its role as the local distribution service provider, it is required by the Act to provide default generation service under its capped rates. According to Northern Neck, supplying default generation services provides a benefit available for all consumers on Northern Neck's distribution system, including those consumers who may choose an alternative power supplier. Northern Neck further stated that the responsibility bestowed on it to provide default service is a function of its role as the distribution utility. Thus, the Cooperative urges the Commission to reject Staff's proposal to assign A&G costs to the G&T functions.

With regard to the Staff's recommendations concerning uncollectible expense, customer deposits, and interest on customer deposits, Northern Neck agreed that a portion of these expenses should be attributed to G&T, but took issue with the Staff's method of allocation. Northern Neck also disagreed with the Staff's assignment of load management costs to the G&T function.

On August 1, 2001, AES filed a Motion to Withdraw its Request for Hearing.³

On August 15, 2001, the Staff filed a Response to Northern Neck's comments on the Staff Report. In response to Northern Neck's assertion that certain A&G costs should be allocated to Distribution, the Staff maintained its position that if these costs are shifted to Distribution, rates established for Distribution will subsidize those of G&T, contrary to § 56-590 D of the Code of Virginia, which requires the Commission to set rates that will not result in cost shifting or cross-subsidies between functional units.

The Staff also reiterated its proposal to functionalize a portion of uncollectible expense, customer deposits, interest on customer deposits, and all costs associated with Northern Neck's load management programs to G&T. In addition, the Staff

³ The Commission granted this motion on August 21, 2001.

disagreed with Northern Neck on (i) the proper ratio to use to allocate a portion of uncollectible expense, customer deposits, and interest on customer deposits to G&T, and (ii) the class or classes to which load management costs should be allocated.

Northern Neck filed its response to the Staff's comments on October 5, 2001. In its response, Northern Neck maintained that failure to attribute additional A&G expenses to the generation function does not result in cost-shifting or cross-subsidization of functionally separate units. In addition, Northern Neck urged the Commission to consider its unique statutory obligation to provide default services in Virginia. The Cooperative continued to agree with Staff that a portion of uncollectible expense, customer deposits, and interest on customer deposits be assigned to the G&T function, but stated that the ratio used should be based on G&T revenues as a percentage of total revenues. With regard to load management costs, the Cooperative maintained its position that 50% of these costs should be considered part of the distribution function. Northern Neck stated it would modify its system of tracking costs, after a final decision is made with regard to what constitutes G&T function costs.

NOW THE COMMISSION, having considered the Cooperative's application, Staff's Report, the subsequent pleadings, and applicable law, is of the opinion and finds that the application

should be approved, subject to the modifications detailed herein.

With respect to the issue of the proper allocation of A&G costs supporting the procurement of wholesale power, we find that the Commission has an obligation pursuant to § 56-590 D of the Code of Virginia to see that no cross-subsidies occur. The function causing the cost should be allocated such costs. A&G costs associated with the procurement of wholesale power support the G&T function, and as such, should not be allocated to the Distribution function. We will, therefore, accept Staff's adjustment allocating certain A&G costs associated with obtaining wholesale power to the Cooperative's G&T function.

There are two ways that a cooperative may recover A&G costs associated with the procurement of wholesale power. If a customer remains with the cooperative, the cooperative will recover such costs from the customer. If the customer leaves the cooperative, and the embedded cost of generation exceeds the market, the cooperative will have the opportunity to recover the cost through the wires charge.

We likewise agree with Staff that the allocation factor for uncollectible expense, customer deposits, and interest on customer deposits should be based on each function's relative level of operating expense. We believe this is a reasonable approach in this situation as total G&T expense must be

calculated in order to determine the level of G&T revenues, and operating expenses can be used to simulate unbundled revenue.

With regard to the costs for load management, we find that these costs should be fully allocated to G&T and should be allocated across all customer classes, not just the residential class. Load management switches installed for peak shaving are a G&T component because they allow the Cooperative to decrease its power costs by negotiating better rates from the supplier, and the Cooperative would not have load management switches simply for distribution purposes. Further, we agree with Staff that since all customers share in the benefits of lower wholesale power bills, all customers should share the costs, not just the residential class.

We find that G&T costs, as defined in this Order, should be tracked prospectively by the Cooperative in order to ensure accurate functional allocations in any future proceedings before the Commission. We also direct the Cooperative to begin tracking the incremental costs associated with billing and collection costs, as well as the activities that give rise to the customer service and legal and regulatory costs.

Finally, although the issue of the impact of the Cooperative's monthly fuel adjustment factor in relation to the determination of the market price for generation and the wires charge was not raised directly in this case, it is a common issue

with respect to cooperatives. Some cooperatives have taken the position that fuel adjustments can be applied monthly without violating §§ 56-582 and 56-583 of the Code of Virginia. We are not persuaded by the cooperatives' argument on this point.

However, because it is not necessary that we resolve this issue prior to January 1, 2002, we will defer our consideration of it until next year. In the interim, we direct the Staff to

(i) consult with Northern Neck, the other electric cooperatives, and any other interested parties on this issue and (ii) submit a written recommendation to the Commission on or before March 1, 2002, on whether we should implement an annual fuel factor adjustment for the cooperatives in lieu of the current fluctuating monthly fuel charge.

Accordingly, IT IS ORDERED THAT:

(1) Northern Neck's Plan for functional separation pursuant to the Virginia Electric Utility Restructuring Act is hereby approved, subject to the modifications discussed herein.

(2) On or before March 1, 2002, the Staff shall submit a written recommendation to the Commission on whether we should transition to an annual fuel factor adjustment for the cooperatives from the current fluctuating monthly fuel charge, and if so, how such a transition should occur.

(3) Northern Neck shall provide tariffs and terms and conditions of service to the Division of Energy Regulation that

conform to this Order and all applicable Commission Rules and Regulations one hundred fifty (150) days prior to its implementation of retail choice.

(4) This case is hereby dismissed, and the papers shall be placed in the file for ended causes.